# The Canadian Chartered Accountant

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MAY 1953

THE CANADIAN INSTITUTE OF CHARTERED ACCOUNTANTS

$5.00 A YEAR - 50c A COPY

The Canadian Chartered Accountant

VOLUME 62 MAY 1953 NUMBER 5



PUBLISHED MONTHLY

By The Canadian Institute of Chartered Accountants

G. P. KEEPING, C.A., *Chairman, Editorial Committee*

Editorial and Business Offices, 10 Adelaide Street East, Toronto, Ontario

MELVILLE PIERCE, *Managing Editor* JEAN VALE, *Assistant Editor*

***Advertising Representative:*** E. L. VETTER, *10 Adelaide St. E., Toronto, **Ont.***
EM. 8-1095

Subscriptions to *The Canadian Chartered Accountant* and *The Tax Review*: $5.00 a year. Additional subscriptions to *The Tax Review*: $3.00 a year.

Single copies 50c. Single copies of *The Tax Review* 50c.

A volume index to *The Canadian Chartered Accountant* is published semi-annually and to *The Tax Review* annually.

Opinions expressed in articles and comment are not necessarily endorsed by The Canadian Institute of Chartered Accountants.

Advertising rates on request

Authorized as second class mail by the Post Office Department, Ottawa

# SWEETNESS and LIGHT

*By Jay Vee*

### Freud for the Masses

IF the first half of the 20th century can be said to have popularized the physical sciences when it put Buck Rogers into every home, the second half will surely be remembered for what it is doing to psychology, sociology, and the other so-called "human" sciences.

The other day we picked up at random the latest issue of a well-known woman's magazine. The leading article invited us to observe in detail the explosive emotions of teen-age race rioters who were merely "denying their basic insecurity through expressions of daring and defiance". Next our eyes were confronted with the illustrated agony of an adolescent who learns she is a "test-tube" baby. Turning over the pages, we diagnosed a case from a psychologist's notebook and when we had ticked off our choice of the three possible explanations of Gwen's marital troubles, we looked back and got the *correct* answer. Finally, we were able to derive a little perverted humour from a psychological satire on whether mothers are necessary to the rearing of their children, though even here we had to wade through questions of post-natal depression, unnatural inhibitions, and acute schizophrenia.

It would be a mistake to think that popular psychology is confined to the housewife's reading material. Recently a number of newspapers across Canada have begun to carry a new comic strip called "The Heart of Juliet Jones", and

## Sweetness and Light

its chief attraction, according to widespread advance advertising, is that it presents "a new problem every day". Monthly digests of general interest are likewise full of self-quizzes on salesmanship ability, social consciousness, and even in-law relationships.

For our money, however, when it comes to popular psychology, nobody can beat the average Canadian farmer. He has been at it for a long time, as have his father and grandfather before him. He has case histories galore at his fingertips, and no social or business contact is so rushed but that he has a chance to make a few accurate observations about the person with whom he is dealing. Generally he is quick to perceive a whole attitude in what might seem like an unimportant mannerism, but on the other hand he is not taken in by the razzle-dazzle of fancy externals. When he does make an analysis, his words are not muddled with inappropriate technical jargon from a textbook.

Maybe one of these days, when the Freudian fad has passed and people yawn at the mention of the Oedipus complex, the farmer's views about human relations will enjoy some of the respect that is their due.

### A Comedy of Errors

THE three learned gentlemen described in this clipping from *The London Times*, March 12, 1953, must by this time be gnashing their teeth at the irony of their lot.

EGYPTIAN LAWYERS GO SOUTH
ALLEGED ARRESTS

FROM OUR OWN CORRESPONDENT

CAIRO, MARCH 11

Dr. Salah ed Din, who was Foreign Minister in the last Wafd Government, accompanied by two colleagues of the Egyptian Bar,

## Sweetness and Light

left Cairo to-day for the Sudan with the intention of defending persons alleged to have been arrested by the British authorities in the south.

None of the three lawyers knew last night whom he was going to defend and—unless there have been some arrests of which no news has reached Cairo—they may have difficulty in finding anyone in need of their services. All the persons arrested in connection with the incident at Aweil in the Bahr el Gazal have been released without trial or acquitted after trial.

Another point which Dr. Salah ed Din and his colleagues did not consider before their impetuous departure is that none of them is licensed to practise under the Sudan criminal code.

If Gilbert and Sullivan were alive today, think what they could have done with a plot like that!

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# COMMENT AND OPINION

## Support for Consolidations

IN the House of Commons on March 3, Mr Charles Parent, M.P. for Quebec West gave utterance to some pungent comments in the course of the Budget Debate, of which we reproduce a part. Mr Parent urged the necessity for consolidated financial statements, and said:

> How can you expect people to invest money in companies if they are going to be at the mercy of the few who do not want to give them any information when they attend annual meetings. Most of the time the old answer that has been used for over 50 years is given, that it is not in the interest of the company that it should be divulged. In the United States you at least have consolidated balance sheets and quarterly statements because it is recognized that investing money is a science, and that you cannot invest money properly unless you have the facts. I believe there should be some such provision in the Companies Act. When we are just starting to scratch the wealth of this country, when we are opening up the oil fields of the west, when we are opening up the north, the Yukon, Labrador and Newfoundland, when these developments are going to bring money into Canada from the United States, why should we not as Canadians be given an opportunity to participate in these developments and at least let the one who wants to risk his money have the certainty that there is a law upon which he can rely in claiming his right to be told what is being done with his money? I know companies that have six or seven subsidiaries and the main companies, which are listed on the stock exchange, are practically showing deficits while the subsidiaries are making hundreds of thousands of dollars.

On a previous occasion, Mr Parent made known his ardent support of the efforts of the C.I.C.A., through its Companies Act Committee, to bring about the change in our Companies Acts which he so vigorously espoused in the Commons in March. The Committee's representations last October to the Dominion-Provincial Conference on Uniform Company Law received then the hearty plaudits of the member for Quebec West who attended the sessions in an unofficial capacity. Mr Parent may be assured that the accounting profession appreciates his support of their efforts to improve financial reporting by securing a change in the law.

## Improving Financial Reports

IN the course of his speech on March 3 Mr Parent referred to an address delivered the night before by Mr W. H. Phillips, district superintendent of the Bank of Montreal, to the Canadian Industrial Editors Association. Mr Phillips said, according to Mr Parent, that confusing terms and lack of information in companies' reports should be done away with, and that the people should be brought into the secrets of the companies in order to know how their money is being spent.

That particular complaint is being heard more and more in recent years,

and not only in Canada. In *The Economist* of February 14 we read the following:

> Directors are slowly coming to realize that a widely spread distribution of shareholdings has advantages that go far beyond a mere selfish wish for a quiet time at the annual general meeting. But there are still a far greater number of directors — and even more managers — who treat "their company" as if it were something apart from the people who own it . . . Most people . . . will . . . have to base their investment decisions largely on published accounts. Education — and even propaganda — through the medium of the annual report should, therefore, become one of the functions of any public company; moreover, since it will be education for the uninitiated, it will have to be imparted through highly simplified methods. To the carefully detailed accounts required by law must be added simplified statements made easily comprehensible. In the past few years, several British companies have issued model simplified accounts — showing precisely and clearly how their profits were earned and allocated, and emphasizing the most important relationships and ratios of the constituent items — and some companies have also followed the American practice of presenting quarterly reports. . . . A mass of information in a company report will, however, merely bewilder the small investor unless it is presented in a clear and attractive way and accompanied by simple but adequate explanations.

With those sentiments, we are sure, Mr Parent and many others will heartily concur.

## AUSTRALIAN ACCOUNTANTS AMALGAMATE

Believing that the number of independent accounting societies in Australia adversely affected the status and prestige of the profession, the Commonwealth Institute of Accountants and the Federal Institute of Accountants have amalgamated, and negotiations are nearing completion for the absorption of the 2500 members of the Association of Accountants of Australia. The new society takes the name "The Australian Society of Accountants" and with the admission of the Association's members, it will have some 18,000 members. A membership of this size will doubtless enable it to claim the largest enrolment of any professional body in the British Commonwealth.

With the demise of the Federal Institute its official organ, *The Federal Accountant,* brought its own 36 year life to a close in December, 1952. Henceforth the official publication of the new and larger society will be *The Australian Accountant.*

# Executive Development And the Chartered Accountant

By S. G. Hennessey, F.C.A.

**Why do some accountants achieve distinction in the execution of high administrative responsibility and others not?**

THE development of executive personnel competent to assume general administrative responsibilities is one of the major problems facing business, organized labour, government, and the armed services at the present time.

The present shortage of experienced able managers is the result of many factors. The difficulty arises in part from the increasing size of individual organizations. Size has certainly contributed to the ever increasing complexity of the enterprises which the administrator must organize, direct, and control. This complexity, in turn, has helped to create the complicated society within which the individual organization must function.

This difficulty is likely to continue. Some of the reasons are obvious. We live in an expanding economy. As organizations grow in size an ever higher percentage of the work force must be designated as supervisors. The present age distribution of senior administrators is unfavourable; depression and war have created a discontinuity which is apparent in many organizations.

Many administrators have not yet recognized clearly the need for careful attention to these problems.[1] Fewer have taken positive action. In Canada, a very small number of organizations are consciously and continuously acting to ensure an adequate supply of executives with a broad background of experience. Some others are aware of the importance of the matter and are planning accordingly, but have not yet made adequate provision for future needs.

## The General Problem

Specialization of a very high order is one of the important characteristics of every kind of organized activity in these days. By breaking down a task into a number of parts or functions each member of a society is able to develop great skill in dealing with the problems which arise within the narrow limits of his responsibility.

This merit is counterbalanced by at least two important disadvantages. Specialization results in problems of co-ordination, that is, of bringing the established parts into proper relation with each other. The difficulty of co-ordina-

[1] For a valuable study of the growing concern of business men in the United States with this management problem see Myles L. Mace, "The Growth and Development of Executives", The Andover Press Ltd., Andover, Mass., 1950.

tion increases quickly with each new special allocation of duties. Secondly, specialization means that individuals will devote their energies to learning more and more about less and less, until, it has been said, they know all about nothing at all. Certainly the mere specialist is not likely to achieve a balanced and integrated view of the many parts of the organization of which he is a part.

Thus, specialization increases the need for executive ability, while at the same time suitable persons seem less and less likely to become available.

The conversion of specialists into administrators able to deal effectively with general problems is one important aspect of the subject of executive development. The remainder of this paper is devoted to some exploration of this theme, with particular reference to chartered accountants.

### The C. A. — A Specialist

Through the past 50 years many chartered accountants have assumed important general administrative responsibilities in industry, government, and elsewhere. Others seemingly as able, and similarly trained, have not achieved the same distinction. By examination of the circumstances surrounding their growth and development we may be able to make valuable observations and reach useful conclusions.

#### *Early Experience and Training*

Most students-in-accounts assume duties of substantial variety; they come into contact with many types of business, large and small, and with government operations; they associate with people having widely diversified backgrounds and responsibilities. These students usually have an opportunity to observe a greater range of economic activity than is possible in almost any other occupation. This would seem to be an ideal beginning for a career leading eventually to most important general assignments. However, one important point must be remembered: throughout this experience their point of view is fundamentally that of the auditor or accountant.

The duties assigned to a student vary with his ability and the work currently undertaken by his employer. They will depend also on the qualifications of the rest of the available staff. Some students are fortunate in that their capacity is fully utilized. Progressively more responsible tasks of great variety are assigned to them. These duties are related more or less directly to the other important areas of specialization — production, sales, and finance. Again the potential advantages are clear. However, the accountant is not required to have more than a general appreciation of the nature of these other areas. He rarely achieves a real understanding of the outlook and attitudes of these other specialists.[2] As a student-in-accounts he approaches, necessarily, perhaps, each new assignment as an accountant pure and simple.

The number of personal associations enjoyed by the student is frequently great. His closest continuing relations are likely to be with the senior accountants within his own firm, and with his

[2] "The Impact of Budgets on People", prepared for Controllership Foundation, Inc. under the direction of Schuyler Dean Haslett by Chris Argyle, both of the School of Business and Public Administration, Cornell University, was published in 1952. This study contains interesting details of the attitudes of "budget people" and factory supervisors toward each other, and toward each other's work. The foreword states " . . . . the verbatim responses and vigorous reactions of factory foremen and supervisors were recorded exactly as given. They are published here undiluted—after merely brushing off some of the mud carried in by earthly words". Every accountant would profit from an examination of the attitudes, analysis, and suggestions for action contained therein.

fellow students. In addition, he will work with a succession of other people, usually employees of the firm's clients, and usually accountants. While the number of associations may be large, the range of interest represented is likely to be surprisingly narrow.

Study groups have been organized by firms of accountants, by student associations, and in some cases by small groups of students. Sometimes these groups have been blessed with competent leadership, but more often the students have been left to get along as best they could using their own resources. In almost every case the subjects for discussion have been strictly confined to technical matters. Frequently the avowed objective has been to "get through the exams". This type of activity seems to contribute little to the achievement of a truly broad point of view and a proper perspective.

Little attention need be directed at this time to the formal courses of instruction which are provided by the Institutes. For the most part they are concerned with the theory and practice of accounting, although supporting and related subjects are included. Suggestions concerning these courses of study are noted below.

Perhaps the most serious deficiency in the early training of accountants lies in the fact that they are concerned too much with the measurement of material things and spend very little time dealing with human problems and giving consideration to the attitudes of people.

Technical knowledge and ability are necessary, of course, but the importance of the leadership, guidance, and direction of people must never be forgotten. Technical training is only one of the qualifications required in a well-balanced executive, and it decreases in significance as his responsibilities become less and less specialized. A full understanding of the human aspects of management is vital and the accountant's training is not

**Admitted to the Ontario Institute in 1946, Professor S. G. Hennessey, B.Com., C.A. is at present a member of the staff of the Institute of Business Administration, University of Toronto. He is director of the Management Conferences conducted by the University and is associated with a variety of activities related to the development of executives.**

particularly conducive to it. Too few accountants ever achieve this comprehension.

There appears to be little doubt that the student-in-accounts confines his attention to a comparatively narrow field. Confined though his horizons may be, however, he is confronted by a terrifying array of facts, theories, procedures, and regulations. Try as he will and able as he may be, his technical studies seem without end. It is not surprising that few students find time and energy for study outside the field of their special responsibility.

*Interests after Graduation*

Having completed the formal requirements, passed the final examinations and been granted the right to use the long-sought appellation, the new member is very likely to sigh, thereby signifying his relief from extreme tension. He frequently makes clear a strong determination greatly to reduce past expenditures of effort, at least temporarily. Almost certainly he will direct less attention to those subjects most featured by the Board of Examiners-in-Chief.

This lack of interest in further immediate exploration of accounting matters may well be wise. This attitude is reasonable, if as a substitute, an attempt is made to achieve a more balanced view of the business community, of the organization with which the accountant is directly associated, and of the society within

which he must work. Most new graduates have not directed adequate attention toward these important subjects. Some few have appraised their own deficiencies and taken action to remove their shortcomings, but such cases seem to be rare.

After being admitted to membership the new accountant will either find himself continuing in public practice or accepting a post in industry or government. If he continues in practice he may be associated with an existing firm or establish himself in independent practice.

Those members who stay in practice are, for most of their working life, likely to be engaged primarily in auditing and accounting activities. There is substantial likelihood that they will be concerned with a small group of clients and these may perhaps have similar interests. Another type of specialization may seem to be desirable; for example, the accountant's responsibilities may be limited to tax matters or the installation of systems.

Some accountants engaged in public practice are making very important contributions to their clients and to the community generally. They are by no means specialists in the narrow sense. They have achieved experience and understanding of the highest order and as consultants play a very important part in the determination of top policy in business and government. When accountants develop this wide understanding, they are particularly well-fitted to undertake general managing responsibility.

Accountants who leave the field of public accounting are almost certain to accept positions wherein their special training and technical knowledge can be applied immediately. They too continue to be specialists, for a time at least. In general, these are the men who have the best opportunity to go on to secure a balanced appreciation of the nature of administration and of the qualities necessary in a great administrator.

It should be noted that many students are stunned by the effort required to pass their final examinations. A few of them never recover any real interest in serious study of any kind. Only those who are strongest, most energetic, or best able to see the specialized nature of their training and the limitations of it have gone on to assume important general appointments.

Many chartered accountants are by nature well-fitted to become senior administrators. Even the rigour of many years of apprenticeship in circumstances least favourable for general development are not likely to seriously decrease their ultimate effectiveness. But the community needs more than those with natural ability and the potential leaders must not be ignored. By appropriate action those with latent powers may become leaders, and the others may develop even greater skill than they would otherwise possess.

In summary, this may be said: the danger is clear that many accountants who are potential senior administrators will never be fully developed. Because of the length and demanding nature of their early training and work experience, and the positions which they have assumed following graduation, many have felt no need or urge to develop further.

The means whereby this failure to develop can be minimized merit consideration.

## The Development of Chartered Accountants for General Administrative Responsibilities

The accountant, like every other specialist, must recognize that participation in management at the top level requires breadth of vision and depth of understanding. He must realize that these qualities cannot be acquired easily or

quickly. Conscious planning is necessary. There must be opportunity for broadening, stimulating, and challenging experience from an early stage in his development. This is the joint responsibility of the accountant and of his supervisor.

### Students-in-Accounts

This developmental process should have modest beginnings during the period spent as a student-in-accounts. Technical training cannot be neglected, but much could be done to encourage a broader appreciation of the accountant's role, of the functions of other specialists, and of the need for co-ordination and co-operation in administrative work.

Specific suggestions can be made. Every supervisor of students-in-accounts must recognize his responsibility as a tutor. Man-to-man coaching on the job is generally accepted as the most important element in the development of competent, imaginative, well-rounded accountants. The supervisor can improve the judgment, initiative, capacity, and thinking ability of his juniors by sharing with them his much greater experience. In all this he should endeavour to relate the accountant's activities to the rest of the organization. It is important to remember that the accountant is only one member of the management group.

The supervisor of students can frequently make a contribution to the growth of his junior by discussing with him the general position of the organization under audit. He should describe the significance of the enterprise in its industry, and of the industry within the broader economic structure.

All public accountants acknowledge an obligation to provide adequate study opportunities for their registered students. Too few of them make serious provisions for the discharge of this responsibility. Without doubt an analysis of examination results would disclose a definite relationship between the success of candidates and the attitude of employees.[3] By arranging and participating in study groups and seminars, by encouraging a broader vision and by attention to job rotation, most students could be given a much more valuable opportunity to grow than is at present available.

Student societies could be a more powerful influence for good than they have been in the past, in most Provinces. Generally, these groups are unable to see the importance of wider considerations, or are unwilling to divert limited energies from the prescribed curriculum. Too often, students are unable to secure the interest of well qualified accountants even for technical presentations. Intelligent and sympathetic interest in student affairs by senior accountants has never been sufficient for the needs. A reconsideration of the relationship between students and members is desirable. Where there is at present no joint activity each group would benefit substantially by joining forces.

The formal courses of instruction should be modified to include consideration of general problems of administration. An effort should be made to examine the basic principles and to see clearly the difficulty of co-ordinating the activities of specialists. Organizational planning and human relations should be included. Many valuable studies of these subjects have been made in comparatively recent years, and much useful material is available. The courses of instruction will be incomplete until attention is drawn to the nature of the responsibilities assumed by a senior executive. In this way the student will

[3] See "Staff Training and Education", by Desmond B. J. Morin, C.A., *The Canadian Chartered Accountant*, April 1952, for a discussion of the contribution which the senior accountants in a firm may make to their students.

have an opportunity to see his own position more precisely, to understand the scope of the accountant's duty, and this would provide a wider horizon for those with ambition and ability.

These proposals may seem likely to increase the students' burden, already too heavy. This must not happen. If necessary, some of the present course content should be dropped to make way for more general studies in administration. After all, no one pretends that present studies embrace the entire accumulation of technical details, and few would contend that many of the topics considered are indispensable. Without doubt the technical aspects would be more meaningful and less onerous if better orientation and perspective were achieved.

Consideration should also be given to the merits of requiring from each student a thesis or dissertation as one of the requirements for the degree. At present too little creative thinking is demanded. Most of the written work required is no more than the re-phrasing of text books. No single substantial investigation is required. Each student might be asked to select a subject of interest to him, to make an extensive study of it, and to present his conclusions at length. In addition to the undoubted benefit to the individual student, much useful research might be initiated.

These are some of the innovations which should be adopted at the present time. In the past too much effort has been directed to training, i.e., drilling, disciplining, cramming, establishing routines, and too little opportunity has been provided for development, i.e., growth, maturity, expansion, and understanding.

### Some Fundamental Considerations

At the present time much interest centres in the development of executives, and much has been written about the subject.[4] This paper cannot deal at any length with the function of executives or methods of executive development. However, some brief reference follows and attention is directed to a few matters of current importance.

Every supervisor recognizes many responsibilities to his subordinates. One of the most important of these is to foster a climate within the organization in which its members can grow. Unless basic considerations are favourable no methods or plans for the development of competent administrators are likely to flourish.

Current attitudes toward executive development and the methods employed vary greatly. In some organizations the matter is left largely to chance. No "program" is ever discussed. Attention is paid to the subject only when a crisis has to be faced. Lack of planning then becomes clear, vows are made, some brief exploration of ways and means may be undertaken, but no real benefits accrue. At the other extreme there are a few organizations with long-established carefully planned executive development programs. Such programs operate continuously and are staffed by men of superior patience, vision, and understanding. Each program attempts to establish the organization's present and future executive requirements, to determine the qualifications most likely to be suitable for all important executive positions, to assess the abilities and performance of individuals in order to plan for their further development and future responsibilities, or, generally, to provide for a constant succession of suitable management personnel.

Administrators develop "on" and "off"

[4] For example, see "The Development of Executive Talent—A Handbook of Management Development Techniques and Case Studies", American Management Association, New York, 1952.

the job. On-the-job experience is a fundamental need for which there can be no substitute. Job rotation, staff duties, and coaching[5] are important methods to be employed in the development of individuals. Off-the-job activities have been receiving greater attention in recent years. A great variety of opportunities exist, and a wide range of techniques and resources are being employed. They include group conferences, role-playing, reading programs, visits to other organizations and many more. Educational institutions[6] are playing an increasing part in providing facilities and leadership.

There is reason to believe that off-the-job activities are particularly important in assisting executives to gain a better balanced, more objective view of their own organization and their place in it. By getting away briefly from direct contact with immediate responsibilities a clearer view of the task in hand is likely to result, particularly if a suitable program of study is undertaken during the interlude. Administrators from every level demonstrate their acceptance of this proposition by ever-increasing participation in executive development programs sponsored by management associations and by a number of universities.

These considerations are as important to accountants as to any other specialists who desire to be effective in their present responsibilities and to progress in due course to more significant duties.

## Conclusion

The administrator who assumes responsibilities of a general nature at or near the top of an organization is responsible for the co-ordination of the efforts of many specialists. His task includes the organization and control of co-operative efforts directed toward a common objective. In order to be effective he must have a balanced understanding of the point of view of each of the specialists under his authority, and be able to see clearly the role of each of them.

The accountant is a specialist. If he is to assume general administrative duties he must somehow achieve the qualifications noted above. This requires careful planning by both the accountant and his employer. The period of development is long and an early beginning is advisable. Much thought has been directed to problems and methods of executive development in recent years, and study of the opinions now available is recommended.

These remarks have been addressed primarily to chartered accountants. They are equally valid in other associations. Lawyers, engineers, all "professional" people, indeed all "specialists", should have an unusually strong common interest in this subject of "executive development".

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[5] See Mace, Ch. 6, for a study of coaching.

[6] Canadian universities now make available important opportunities for serious studies in administration. Anyone who is interested can secure details of the programs by application to his local university. Much more can be done if the business community expresses the need.

# A Report on the Cash Discount Fiction

**By Arthur Blake, C.P.A.**

**Accounting theories and practices in respect of cash discounts are numerous and divergent**

A BUYER for a large retail business was examining a manufacturer's sample line and thoroughly enjoying the dispute over prices and terms. The salesman, however, finally exasperated, exclaimed, "You wouldn't take them if I gave them to you for nothing." "Of course I wouldn't take them for nothing," replied the buyer, "I'd lose my discount."

Another buyer in a different organization was asked to participate in a storewide sale. After the sale he commented freely on having maintained his customary mark-up percent despite reduced selling prices, by means of special purchases skilfully arranged with his suppliers. Later it was learned that the special purchases had been on "terms: net cash" and that the reduced prices had been partly due to the loss of the store's usual 8% discount.

### The Problem

It does not appear that a supplier offering a high rate of cash discount thereby offers his customers better value for their dollar outlay than they can obtain from a supplier offering a lower rate of discount. This viewpoint is reflected in the practice of reporting sales net of cash discounts, as well as returns and allowances, on financial statements. However, it is quite generally contradicted by the practice of reporting purchase discounts as "Other income", after "Net operating profit". Many companies treat purchase discounts as deductions from cost of goods sold, with favourable effects on their gross profit and net operating profit. These practices do not produce comparable results and published financial statements seldom reveal which practice is followed. Further variation is found in methods of determining the amounts of cash discounts to be reported in a given period. Many companies adjust for discounts included in merchandise inventories, accounts receivable, and accounts payable. Many do not.

It is evident, therefore, that cash discounts are treated as cost reductions by some companies and as revenue by others. Both cannot be correct procedures. Logically, according to the law of contradiction, cash discounts cannot have the quality of cost component and at the same time (as other income) not have it; or

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cannot have the quality of revenue and (as cost reduction) not have it.[1]

### General Treatment in Accounting Literature

The problems presented by these divergent practices are recognized and discussed in accounting literature. According to one authority, "The distinction between cost savings and actual, realized earnings is not always clearly drawn in accounting procedure. The outstanding example is the question of the treatment of purchase discounts."[2] Most writers of accounting texts describe four methods of reporting purchase discounts. They are:

1. Amount actually realized, reported as other income.
2. Discounts at the rate of 2% or less, reported as other income; discounts at higher rates deducted from cost of goods sold.
3. Amount actually realized, deducted from cost of goods sold.
4. Purchase invoices entered net of all discounts, cash and trade; lost discounts entered as expense.

The second and third methods are generally favoured by those authors who expressed their opinions.

### Other Income

The first method, by which all purchase discounts are reported as other income, seems to rest upon the following concept: cash discounts are deductions allowed to customers to induce them to pay their bills within a definite time. This suggests that the discount is a fair price for the time by which the credit period is shortened. The fallacy of this concept is shown in several ways. First, the rate of return represented by the cash discount is beyond reasonable limits. Even a low rate of discount, such as 2/10 n/30, means that supplier is paying 2% for 20 days anticipation of net settlement, an effective rate of 36% per annum. Money is not worth that much on a going concern basis. It thus appears that the cash discount is a penalty imposed against slow payment. Second, when planning a selling price, the required return to the supplier is considered covered by the net cash price and an amount representing the intended cash discount is then added. A supplier who needs, for example, $92 to cover costs and a fair profit on a given item and who is led by trade custom to offer an 8% cash discount must establish a loaded selling price of $100 which he neither needs nor generally expects to collect. He expects and will be satisfied with $92. From this it appears that the customer who takes the cash discount pays in full for the goods invoiced and merely avoids a penalty for delayed payment. Nor does it appear that a customer who fails to take the discount receives an asset of greater value as a consequence. Cost then ceases to be a measure of value.

There are other objections to this method. "As a general principle, profits are not made on purchases. A company cannot earn income merely by purchasing merchandise or fixed assets and taking the discounts, without making a sale."[3] In addition, taking all discounts is a requisite of efficient management. Hence it is not the discount taken which is significant but the discount lost.

Unfortunately, many textbook writers describe this method without discussion in the early pages of their writings. Students of management and marketing who might benefit from clear concepts of the role of the cash discount may therefore

[1] Ewing, A. C., *The Fundamental Questions of Philosophy*, p. 22

[2] Paton, W. A., (Ed.), *Accountants Handbook*, p. 165

[3] Finney, H. A., *Principles of Accounting, Intermediate*. (3rd Ed.), p. 203

complete the study of basic accounting believing that it is good business practice to pay 2% for example, to accelerate cash collection by 20 days.

## Part Other Income, Part Cost Savings

The second method distinguishes between cash discounts which are cost savings and those which are revenue or other income. This is consistent with Income Tax Regulations which provide that merchandise purchases may be valued at "the invoice price less trade or other discounts, except strictly cash discounts approximating a fair interest rate,—".[4] Cash discounts which even at the low rate of 2/10 n/30 represent an effective annual rate of 36% do not approximate a fair interest rate. The "fair interest rate" test is relevant, not because of tax regulations, but because of its inherent logic in relation to the concept that cash discounts are offered to induce earlier cash settlement. Even 1/10 n/60 represents an effective rate of over 7% annually.

Those writers who report this method as an accepted business procedure, generally advocate treating discounts in excess of 2% as deductions from cost of goods sold, either separately stated or as trade discounts deducted directly from the invoices. There is general agreement on the reasoning. "Normally, however, a purchase discount in excess of 2% regardless of the net date, is viewed as a trade discount offered as an inducement to purchase or offered for large quantity purchase."[5] They do not deal with cash discounts included in merchandise inventories, accounts receivable, and accounts payable, on the balance sheet.

## Cost Savings Entirely

The third method reports the amount of cash discounts actually realized upon the settlement of the liabilities and treats them as a reduction of the cost of goods sold. Accounting literature generally favours this method equally with the second method that treats only those discounts in excess of 2% as cost reductions. This method recognizes the nature of cash discounts as cost savings but has several material weaknesses. "The accounts do not show how much discount was lost by failure to pay bills within the discount period."[6] Moreover, the accounts and statements do not reflect professional skill unless periodic adjustments are made to convert the accounts from the cash basis to an accrual basis in respect of cash discounts. To do so necessitates an inventory valuation account, "Inventory Discounts Unearned", with a credit balance; and a valuation account for trade accounts payable, "Discounts Available on Accounts Payable", with a debit balance.[7] The "Purchase Discounts" account, on an accrual basis, then bears its true relationship to cost of goods sold. Leading firms of accountants have followed this practice for the past quarter century but it has not had full treatment in accounting literature. The chief weakness of this procedure is that it leaves cost of goods sold loaded with discounts lost, as though failing to take a discount could enhance the value of the goods so acquired.

**Arthur Blake, C.P.A., is Assistant Professor of Business, Champlain College, State University of New York. He holds the degrees of B.C.S. and M.C.S. from New York University and A.M. from Fordham University. He is a member of the American Institute of Accountants, and of the American Accounting Association.**

[4] Reg. 111, *Income Tax Regulations.* Sec. 29-22(c)-3. Par. (2)

[5] Holmes, A. W., and Meier, R. A., *Intermediate Accounting*, p. 98

[6] Finney, H. A., *Principles of Accounting, Introductory*, p. 381

[7] Paton, *op. cit.*, p. 886

### Net of All Discounts

The fourth method provides for entering all invoices net of all discounts, based on the reasonable expectation that all discounts will be taken. Discounts lost by delay in settlement are then recorded as expenses consistent with principles of internal control. This procedure penetrates the "cash discount" fiction and views such cost savings as "trade discounts" by their nature. One technical authority states it clearly: "Such terms as 8/10 E.O.M. and 6/10/60 are really trade discounts. They are not allowed in order to induce payment, but are given because of existing trade practices. When a trade discount is allowed, the purchase is entered upon the books of account at the net price after the discount has been deducted."[8] An authority on auditing supports this. He writes, "—cash discounts on purchases are preferably considered reduction of invoice price or cost of sales—".[9] A leading accounting writer sums it up thus: "The theoretically sound method of treating purchase discounts is to show purchases net, and to treat the purchase discounts not taken as a financial expense.[10]

This method has the advantages of utmost simplicity, easily achieved uniformity, and theoretical soundness, as well as many advantages for control and management.

### Technical and Practical Advantages

The advantages of entering all invoices net of cash discounts, in respect of merchandise purchases, are as follows:

*Merchandise inventories*: Cost net of cash discounts, or cash outlay, most closely measures the value of the merchandise for inventory purposes, except for unusual conditions. Values are not inflated by amounts representing collection incentives or trade customs capitalized.

*Accounts payable*: The liability is reported as the aggregate of actual payment to be made in terms of effect upon the asset cash. It is not inflated by an amount which the company, is the ordinary course of business, will not pay.

*Gross profit*: Percentages of gross profit in relation to net sales are consistent and comparable among similar businesses, among departments in a given business, and from year to year. Results are not affected by extraneous factors such as variations due to trade and local customs, discounts not taken, and special arrangements with suppliers.

*Net operating profit*: Percentages of net operating profit in relation to net sales are consistent and comparable, in respect of merchandise and discount transactions, among similar businesses and from year to year. Results are not affected by divergent practices of reporting cash discounts on a cash or accrual basis and giving effect to them, in whole or in part, as other income or as cost savings.

*Management and control*: Marketing and merchandise management are not complicated by varying rates of cash discount or no discount on materials handled. Adequate internal control is maintained over cash discounts lost. Bookkeeping is simplified by elimination of discount columns in books of original entry. Adjusting entries to accrue available discounts on accounts payable and to defer unearned discounts on merchandise inventories are not needed.

### Conclusion

The purpose of the cash discount offering is to control the time between receipt

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[8] Tunick, S. B., and Saxe, E., *Fundamental Accounting—Theory and Practice*, p. 7

[9] Montgomery, R. H., Lenhart, N. J., and Jennings, A. R., *Auditing* (7th Ed.), p. 431

[10] Holmes, *op. cit.*, p. 98.

of the goods and settlement of the account and to differentiate between the treatment accorded the slowpay customer and that enjoyed by the typical customer who pays promptly. The only lapse of time contemplated by the parties to the transaction is the period required to complete the procedures for receiving the goods physically and for writing the accounting records. This describes the usual situation.

Loss of the cash discount by the purchaser is due to financial incapacity or inefficiency in most cases. The lost discount, therefore, is a measure of the quality of financial or operational management. It should be given effect as such in financial statements. It is no part of the function of cash discounts taken or lost to increase or diminish the effect of merchandise as a profit factor in the ordinary course of business.

The cash discount, therefore, appears as an unnecessarily complicated and somewhat immature disguise for a penalty or pressure device. Costs of credit controls ought not be concealed in the costs of merchandise sold or on hand.

Business would do well to abolish the cash discount and to maintain its credit terms by requiring prompt payment as an essential part of satisfactory credit standing. Until this step is taken the same effect can be had by deducting cash discounts from purchase invoices before entry on the accounting records.

# The "T" Account Method for Solving Fund Statement Problems

By Lewis N. Greer, B.Com., M.B.A., C.A.

**Football found in the T formation a successful offensive device. The "T" account method offers comparable advantages in accounting**

THE MAY 1952 issue of *The Canadian Chartered Accountant* contained an article by Robert H. Gregory, "A Simplified Working Sheet for Solving Fund Statement Problems". In the article Mr. Gregory states: "It enables a person to work a funds problem in less time than is required by conventional working sheets, "T" accounts, or schedules".

What is meant by the "T" account method? This method was conceived by Professor William J. Vatter, University of Chicago, and appeared in the June 1946 issue of *The Journal of Accountancy* and is now incorporated in the text "Intermediate Accounting" by Holmes and Meier. I have used this method at the University of Saskatchewan with great success, and am presenting it in the hope that others may find it useful in solving fund statement problems for examination or for practical purposes.

### One Important Fact

While I do not propose to cover the underlying theory of the statement of source and application of funds, I want to emphasize and clarify one fact which many fail to grasp — *changes in working capital are the result of changes in non-working capital accounts.* To illustrate, assume that X Co. Ltd.'s balance sheet on June 30, 1952, was as follows:

| | |
|---|---|
| Current Assets | $200,000 |
| Fixed Assets | 250,000 |
| | $450,000 |
| Current Liabilities | $100,000 |
| Share Capital | 200,000 |
| Earned Surplus | 150,000 |
| | $450,000 |

The working capital as at June 30, 1952, is $100,000 (current assets minus current liabilities). If in July 1952 X Co. Ltd. purchased new equipment costing $50,000 for cash, the above balance sheet would be changed to:

| | |
|---|---|
| Current Assets | $150,000 |
| Fixed Assets | 300,000 |
| | $450,000 |
| Current Liabilities | $100,000 |
| Share Capital | 200,000 |
| Earned Surplus | 150,000 |
| | $450,000 |

The working capital is now $50,000 (current assets minus current liabilities).

What caused the decrease in working capital from $100,000 as at June 30, 1952, to $50,000 as at July 31, 1952? It is obvious from the above that the decrease is the result of an increase in fixed assets.

### Reduction of Complexity through the "T" Account

All problems are not as easy as this, but their complexity can be reduced by a simple direct method known as the "T" account method. Before outlining the "T" account method in detail, the essential mechanics may be portrayed by continuing the above illustration.

Working capital decreased $50,000 which according to the rules of debit and credit results in a credit to the group of accounts comprising working capital. Fixed assets increased $50,000 which must be the result of debit entries. These changes are recorded in "T" accounts illustrated below:

| Working Capital | | Fixed Assets | |
|---|---|---|---|
| | $50,000 | $50,000 | |
| (a) | | (a) | |
| | (1) 50,000 X | (1) 50,000 X | |

The amount entered in each account is ruled off by drawing a line across the account (line (a)). This is necessary in order that further entries may be made which will account for the dollar change entered therein.

It is important to realize, as stated in paragraph 3, that changes in working capital are the result of changes in non-working capital accounts. Therefore, if we can account for the changes in the non-working capital accounts we can account for the change in working capital.

Analyzing the information available in the above illustration we find that fixed assets in the amount of $50,000 were purchased for cash. The entry made by the company to record this transaction is the entry that must be made in the "T" accounts. The entry is as follows:

| | | |
|---|---|---|
| (1) Dr. Fixed Assets ........ | $50,000 | |
| Cr. Cash ............... | | $50,000 |
| (Working Capital) | | |

Referring to the "T" accounts, we notice that we have a credit entry in working capital of $50,000 which balances the net change entered above the ruling line, and a debit entry in fixed assets of $50,000 which balances the net change entered above the ruling line. Having accounted for the changes in the "T" accounts set-up, it is suggested that each account be designated as cleared by using X as a notation for clearance.

The working capital "T" account contains all of the details necessary for the preparation of the formal statement of source and application of funds. Entries on the debt side are sources of funds, and those on the credit side are applications or dispositions of funds.

### Procedure Summarized

The procedure illustrated above may be summarized into the following steps:

(1) Compute the change in working capital. The best method of doing this is to set up the formal statement of changes in working capital. This statement is required as part of the statement of source and application of funds, and by doing it in the beginning duplication of work is eliminated.

(2) Rule ledger accounts in "T" form with a single account for working capital, and separate accounts for the various "non-working capital accounts" (non-current assets, long-term liabilities, share capital, surplus, and profit and loss).

(3) Enter the net changes in these accounts and rule them off.

(4) Reconstruct the entries required

to record the changes in the "T" accounts.

(5) Clear the accounts by determining that the balances above and below the ruling line are equal.

(6) Prepare the formal statement of source and application of funds from the information in the working capital and profit and loss "T" accounts.

In order that the reader may compare the "T" account method and the method outlined by Mr. Gregory, the same problem follows as an illustration (*Question 5, Accounting II, Intermediate Examination, October 1950*):

A comparative post-closing trial balance of the F Co. Ltd. is as follows:

Mr. Lewis N. Greer, B.Com., M.B.A., C.A., graduated from the University of Saskatchewan in 1948 and was appointed accounting instructor in the University's College of Commerce. He became an assistant professor in accounting. In 1949 he received the degree of Master of Business Administration from the University of Chicago. Since then he has been articled to Rooke, Thomas & Co., Regina, and in 1952 was successful in the final examinations for admission to the Saskatchewan Institute.

| | 31st December 1948 | 31st December 1949 |
|---|---|---|
| Bank | $ 160,000 | $ 210,000 |
| Marketable securities | 120,000 | 80,000 |
| Accounts and notes receivable less allowance for bad debts | 220,000 | 250,000 |
| Inventories | 300,000 | 360,000 |
| Investments in stock of subsidiary companies (at cost) | 350,000 | 240,000 |
| Buildings and equipment less allowance for depreciation | 800,000 | 1,020,000 |
| Patents and goodwill | 140,000 | 36,000 |
| | $2,090,000 | $2,196,000 |
| Miscellaneous accrued liabilities including taxes | $ 90,000 | $ 85,000 |
| Accounts and notes payable | 160,000 | 180,000 |
| 4% mortgage bonds | 500,000 | 400,000 |
| Preferred stock (par $25, each share convertible into two shares of common) | 250,000 | 210,000 |
| Common stock (par value $10) | 300,000 | 432,000 |
| Paid-in surplus | 200,000 | 258,000 |
| Earned surplus | 590,000 | 631,000 |
| | $2,090,000 | $2,196,000 |

An analysis of the trial balance changes discloses the following:

(a) Stock owned in the X Co. Ltd., a partially owned subsidiary, was sold for $200,000. Stock had originally cost $110,000.

(b) The entire goodwill of $100,000 was written off the books in 1949.

(c) The patents had a remaining life of 10 years on 31 Dec 1948, and are being written off over this period.

(d) Mortgage bonds mature on 1 Jan 1959. On 1 July 1949, bonds of $100,000 were purchased on the market at 103½ and cancelled. The premium on bond retirement was charged to earned surplus.

(e) The decrease in preferred stock outstanding resulted from the exercise of the conversion privilege by preferred stockholders.

(f) During the year 10,000 shares of common stock were sold at $15 each.

(g) During the year equipment costing $60,000 with a net book value of $12,000 was sold for $8,600. Depreciation of $64,000 was taken during the year on buildings and equipment. Additional changes in the buildings and equipment balance resulted from the purchase of new equipment.

(h) The net income for the year transferred to earned surplus was $107,900.

(i) Dividends declared during the year totalled $50,000.

**Required:**

Submit a statement of source and application of funds and statement of changes in working capital.

Step 1: Prepare the statement of changes in working capital.

F CO. LTD.

STATEMENT OF CHANGES IN WORKING CAPITAL
as at 31 Dec 1949

| | | | Working Capital | |
|---|---|---|---|---|
| **Current Assets** | **1948** | **1949** | **Increase** | **Decrease** |
| Bank | $160,000 | $210,000 | $ 50,000 | |
| Marketable securities | 120,000 | 80,000 | | $ 40,000 |
| Accounts & notes receivable—Net | 220,000 | 250,000 | 30,000 | |
| Inventories | 300,000 | 360,000 | 60,000 | |
| | $800,000 | $900,000 | | |
| **Current Liabilities** | | | | |
| Accrued liabilities including taxes | $ 90,000 | $ 85,000 | $ 5,000 | |
| Accounts & notes payable | 160,000 | 180,000 | | $ 20,000 |
| | $250,000 | $265,000 | $145,000 | $ 60,000 |
| Working capital | $550,000 | $635,000 | | |
| Increase in working capital | 85,000 | | | 85,000 |
| | $635,000 | $635,000 | $145,000 | $145,000 |

Steps 2 and 3: Set up "T" accounts for the changes in working capital and the non-working capital accounts. Enter the changes as debits or credits and draw a line under them as illustrated below:

Working Capital

| | | | |
|---|---|---|---|
| | $ 85,000 | | |
| (a) Sale of investment in subsidiary cos. | 200,000 | (d) Redemption of bonds | $103,500 |
| (f) Sale of Common shares | 150,000 | (g)-3 Purchase of equipment | 296,000 |
| (g)-1 Sale of equipment | 8,600 | (i) Dividends | 50,000 |
| (j) By profits | 175,900 | | |

**Investment in Stock of Subsidiary Companies (at cost)**

| | |
|---|---|
| | $ 110,000 |
| | (a) 110,000 |
| | X |

**4% Mortgage Bonds**

| | |
|---|---|
| $ 100,000 | |
| (d) 100,000 | |
| X | |

**Buildings & Equipment less allowance for depreciation**

| | |
|---|---|
| $ 220,000 | |
| (g)-3 296,000 | (g)-1 12,000 |
| | (g)-2 64,000 |
| X | |

**Preferred Stock**

| | |
|---|---|
| $ 40,000 | |
| (e) 40,000 | |
| X | |

**Patents & Goodwill**

| | |
|---|---|
| | $ 104,000 |
| | (b) 100,000 |
| | (c) 4,000 |
| | X |

**Common Stock**

| | |
|---|---|
| | $ 132,000 |
| | (e) 32,000 |
| | (f) 100,000 |
| | X |

**Earned Surplus**

| | |
|---|---|
| | $ 41,000 |
| (b) $100,000 | (a) 90,000 |
| (d) 3,500 | (h) 107,900 |
| (g)-1 3,400 | |
| (i) 50,000 | |
| X | |

**Paid-in Surplus**

| | |
|---|---|
| | $ 58,000 |
| | (e) 8,000 |
| | (f) 50,000 |
| | X |

**Profit and Loss**

| | | | |
|---|---|---|---|
| | $ nil | | $ nil |
| (h) Net profit | 107,900 | (j) To working capital | 175,900 |
| (c) Write off patents | 4,000 | | |
| (g)-2 Depreciation | 64,000 | | |
| | X | | |

Step 4: Reconstruct the entries required to record the changes in the "T" accounts.

The problem outlines changes as supplementary information which is used as the basis for accounting for the changes set out in the above "T" accounts.

(a) Working capital .......... $200,000
Investment in stock of subsidiary companies .......... $110,000
Earned surplus .......... 90,000

This is the same entry as made by the company with the exception that the debit to cash is reflected as a debit to working capital as the sale resulted in the provision of working capital.

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(b) Earned surplus .......... $100,000
Patents & goodwill .......... $100,000

To record the write off of goodwill. This entry does not involve funds but must be made to account for the changes in the accounts.

---

| | | | |
|---|---|---|---|
| (c) | Profit & loss | $ 4,000 | |
| | Patents & goodwill | | $ 4,000 |

To write off 1/10 of patents of $40,000. This is a non-fund entry which must be made to account for the changes in the accounts, and determine the funds provided by profit.

| | | | |
|---|---|---|---|
| (d) | 4% Mortgage bonds | $100,000 | |
| | Earned surplus | 3,500 | |
| | Working capital | | $103,500 |

To record the redemption of bonds of $100,000 at 103½.

| | | | |
|---|---|---|---|
| (e) | Preferred stock | $ 40,000 | |
| | Common stock | | $ 32,000 |
| | Paid-in surplus | | 8,000 |

Conversion of 1,600 preferred shares into common shares, 1 preferred for 2 common.

| | | | |
|---|---|---|---|
| (f) | Working capital | $150,000 | |
| | Common stock | | $100,000 |
| | Paid-in surplus | | 50,000 |

Sale of 10,000 shares at $15 per share.

| | | | |
|---|---|---|---|
| (g)-1 | Working capital | $ 8,600 | |
| | Earned surplus | 3,400 | |
| | Building & equipment | | 12,000 |

To record the sale of equipment.

| | | | |
|---|---|---|---|
| (g)-2 | Profit & loss | $ 64,000 | |
| | Building & equipment | | $ 64,000 |

To record depreciation for the year. This is a non-fund entry which must be made to account for the changes in the accounts and determine the funds provided by profits.

| | | | |
|---|---|---|---|
| (g)-3 | Buildings & equipment | $296,000 | |
| | Working capital | | $296,000 |

Problem states that the additional charges resulted from the purchase of new equipment.

| | | | |
|---|---|---|---|
| (h) | Profit & loss | $107,900 | |
| | Earned surplus | | $107,900 |

This is the entry made by the company to close profit & loss to surplus. This entry records the profit as a debit to profit & loss in order that we may arrive at the funds provided by profits during the period.

| | | | |
|---|---|---|---|
| (i) | Earned surplus | $ 50,000 | |
| | Working capital | | $ 50,000 |

To record dividends declared and paid.

Step 5: After analyzing and recording all of the available data, the next step is to follow through all of the "T" accounts and make sure that we have accounted for the changes. It appears that all changes have been accounted for except working capital and profit. The profit & loss account discloses the net profit per statement plus the non-fund charges.

The total should be transferred to working capital—

| | | | |
|---|---|---|---|
| (j) | Working capital | $175,900 | |
| | Profit & loss | | $175,900 |

To transfer funds provided by profits to working capital account.

---

Step 6: The working capital and profit and loss accounts contain all of the information required for the formal statement of source and application of funds. In working out problems it is suggested that details of entries in working capital and profit and loss accounts be recorded in order to avoid re-examination of entries which would result if only letters or numbers were used.

---

F CO. LTD.

STATEMENT OF SOURCE AND APPLICATION OF FUNDS
for the year ended 31 Dec 1949

| | | | |
|---|---|---|---|
| **Source of Funds:** | | | |
| Net profit for period | | $107,900 | |
| Add: Items not requiring outlay of funds | | | |
| Depreciation | $ 64,000 | | |
| Patent write-off | 4,000 | 68,000 | |
| | | | $175,900 |
| Sale of X Co. Ltd. stock | | | 200,000 |
| Sale of 10,000 common shares at $15 | | | 150,000 |
| Sale of equipment | | | 8,600 |
| | | | $534,500 |
| **Application of Funds:** | | | |
| To redeem bonds at 103½ | | 103,500 | |
| To pay dividends | | 50,000 | |
| To purchase fixed assets | | 296,000 | 449,500 |
| Increase in working capital | | | $ 85,000 |

## Hidden Transactions

If on clearing the "T" accounts you find that an account is not cleared and you are satisfied that all of the given facts are recorded, you then assume that it is a hidden transaction. An entry must be made to clear the account(s). A decrease in surplus and an increase in share capital would indicate a stock dividend which would be reflected by the entry:

| | | |
|---|---|---|
| Earned Surplus | xxxx | |
| Share Capital | | xxxx |

An unexplained increase in fixed assets indicates a purchase of assets for cash or an appraisal. If there is no unexplained increase in a surplus account then assume that it is a cash transaction reflected by the entry:

| | | |
|---|---|---|
| Fixed Asset | xxxx | |
| Working Capital | | xxxx |

## Conclusion

The "T" account method illustrated above supports Mr. Gregory's proposition that there is no sound reason why the funds working sheet should use reversing entries. You are concerned with accounting for the changes in the accounts as recorded by the company in order to determine the source and application of funds. It is easier to do this by making the entries actually recorded by the company, than by making revers-

ing entries. However, it is easier still to follow through the changes in the accounts by setting these accounts up separately, as illustrated above, than to follow them on a large working sheet.

In solving a problem an attempt should be made to provide a simple, direct approach that eliminates duplication of work, enables one to proceed in an orderly comprehensible manner, and admits of solution in a minimum of time. In my opinion, the "T" account method offers such an approach to fund statement problems.

## B.C. INSTITUTE SEEKS A DIRECTOR OF EDUCATION

With a membership which has almost doubled in the last five years, the B.C. Institute is now faced with greatly increased problems pertaining to the affairs of its students and members. The Institute's Council, which has always been most interested in maintaining the highest possible standard of student education, has for some time supplemented the Chartered Accountants Courses of Instruction with a complete series of lectures directly related to the course work, given by members of the Institute under the administration of the Committee on Education and Examinations. Since a more formal organization is now deemed necessary, Council has decided to engage a chartered accountant as director of education and assistant secretary-treasurer of the Institute. Details of the position will be found in an advertisement on page X of this issue.

# Recent Books

**C. P. A. Handbook, edited by Robert L. Kane, Jr.; published by American Institute of Accountants, New York; vol. 1, pp. 912 approx.; vol. 2 to be issued shortly; price, two volumes $27 U.S.**

For the first time public accountants have available a comprehensive reference work which provides detailed information relating to the management of a public accounting practice. Volume 1, which is now available, is the work of 13 authors, mostly practising accountants, each of whom, however, consulted other accountants as to how problems were dealt with in their own offices. Each of the thirteen chapters is bound as a separate booklet and the whole is contained in a post binder.

Chapter 3 discusses in detail the important subject of accountants' partnership agreements. Extracts are given from numerous agreements and the chapter should be very helpful to accountants who have intended to prepare a satisfactory agreement but who have not done so, perhaps because of the lack of guidance from other accountants.

A thorough discussion of office organization and records includes consideration of office arrangement, equipment, filing systems, time reports, and ledgers, etc. Examples of office forms are contained in a substantial appendix from which an accountant should be able to plan suitable forms for his own office.

A chapter on office procedures for correspondence and reports contains this observation: "It is surprising to the uninitiated that so many methods and varieties of procedures exist in the offices of accountants with similar practices. Many are far from efficient. It is evident that there is a need for greater attention on the accountant's part toward making his office methods as efficient as those he installs for his clients." A 60-page style manual for report writers and typists is included in this section.

This work should be of considerable assistance to practitioners who desire to continue the progress of the profession and improve their service to the public.

ALBERT C. JOHNSTON, C.A.
*Toronto, Ontario*

**Selected Readings in Accounting & Auditing, selected by Dr. Mary E. Murphy; published by Prentice-Hall, Inc., New York, 1952; 431 pp.; price $5.25 U.S.**

One cannot fail to be impressed by the amount of research and reading which must have preceded the preparation of this work. Miss Murphy has made a worthwhile contribution by viewing the bulk of accountancy literature in retrospect and selecting a number of items of lasting significance.

As editor, Miss Murphy has generally confined her selection to articles, reports, and books published since about 1940. A notable exception is an excerpt on accounting for holding companies from a book by Sir Arthur Lowes Dickinson published in 1922 — to prove at least that not all the worthwhile pronouncements in accountancy have been recent pronouncements.

The articles which gave this reviewer the most pleasure personally were (in the order of their appearance), Garner's "Historical Development of Cost Accounting", Kohler's, "The TVA and its Power-Accounting Problems", Butters',

"Management Considerations on Lifo", Fitzgerald's, "The Classification of Assets", and Montgomery's, "What Have We Done and How?" Of special interest also is the article by Maurice H. Stans, "Weaknesses in Present Accounting Which Inhibit Understanding of Free Enterprise", and George O. May's reply, "The Choice Before Us". These last two items were part of a classic exchange of ideas which appeared in *The Journal of Accountancy* through 1948 to 1950 on the subject of the need for standardizing accounting practice and principles. They generated considerable heat at the time and make lively reading.

The editor has inserted a preamble of her own at the head of each chapter, giving a brief biography of the authors of the articles which follow. This is material which in itself is generally unavailable and of course it adds to the interest of the articles.

The reviewer confesses, however, to being somewhat disturbed by Miss Murphy's practice of making deletions from many of the pieces she selected. To illustrate the point: 43 pages of F. Sewall Bray's *The Measurement of Profit* emerge as 13 pages in Miss Murphy's book. The effect of the deletions is occasionally to make the reading disjointed and rather generally to make one curious about what has been omitted.

Miss Murphy has included extracts from "A Statement of Accounting Principles", by Sanders, Hatfield and Moore, and also the "1948 Revision of Accounting Concepts and Standards Underlying Corporate Financial Statements" by the American Accounting Association. The anthology might have been improved — and definitely made exciting — by including also some of the sharp criticism of these two statements which appeared in *The Journal of Accountancy* immediately following their publication. See for example W. A. Paton's uninhibited comments on the former statement in the March 1938 issue, and George O. May's scathing remarks about the latter statement in the November 1948 issue.

An obvious omission from any anthology is one of those memorable articles by Henry Rand Hatfield—"What is the Matter with Accounting?", "An Historical Defence of Bookkeeping", or "What They Say about Depreciation". These are classics.

*Selected Readings in Accounting & Auditing* invites comparison with a slightly prior book, *Studies in Accounting* by W. T. Baxter (Sweet & Maxwell, Limited, London, 1950). But the two books are more nearly complementary than competitive: for example, Professor Baxter includes two of the Hatfield articles, and there is no duplication at all. Baxter's declared objective is "not to compile an anthology of all that is best in accounting, but to fill gaps with material that is hard to come by".

Until 1950 there were no collections of readings in accountancy subjects. The appearance of two such works in short succession marks an awakening of interest in that hitherto neglected field, the literature of accountancy. Accountants labour under the inferiority complex that they cannot write well. And now we have two volumes of readings to show that at least some of them can, and do write well. The appearance of these books is also a reminder that our advanced university accounting courses have concentrated too much on problems, not enough on the assignment of readings and the class discussion of them. And quite apart from academic considerations, the practising accountant is now afforded an easy access to the literature of his profession, and has now an opportunity to gain new perspective as an accountant.

J. E. Smyth, C.A.
*Queen's University*

# Professional Notes

## C.I.C.A. President Visits Quebec and Ontario Institutes

Mr Lorn McLean, president of the C.I.C.A., addressed the convocation of the Quebec Institute on Saturday, March 14 at the Ritz-Carlton Hotel and presented the C.I.C.A. gold medal and prize to Mr Edward Netten, the 1952 winner. That evening Mr and Mrs McLean were entertained at a dinner party given by Mr J. A. de Lalanne, president of the Quebec Institute, and Mrs de Lalanne.

On Monday, March 16, Mr McLean met with members of the Quebec Council to discuss matters of common interest.

Other members of the C.I.C.A. executive attending the convocation were Mr W. J. Macdonald, first vice-president, and Mr C. L. King, secretary. Mr. King was accompanied by his wife.

Mr and Mrs McLean then went to Toronto where on March 20 Mr McLean met with the members of the Council of the Ontario Institute. At the annual dinner of the Institute held in the Royal York Hotel that same evening, Mr McLean again made a presentation to a prizewinner — this time the C.I.C.A. silver medal and prize to Mr V. G. Seadon.

## ALBERTA

McDonald, Currie & Co., Chartered Accountants, announce the opening of an office at 110 Commercial Bldg., Edmonton. Mr Herbert Hartley, C.A., formerly of Toronto, will be resident partner.

* * *

Mr H. R. Ballard, B.A., B.Com., C.A., announces the opening of an office for the practice of his profession at 225 Examiner Bldg., Calgary, Alta.

## BRITISH COLUMBIA

R. E. Sayce & Co., Chartered Accountants, announce the removal of their offices to 1726 West Broadway, Vancouver.

* * *

Messrs Paul Rising, C.A. and Alexander F. Learmont, C.A. announce the admission to partnership of Mr Winston M. Foster, B.Com., C.A. Henceforth practice of the profession will be conducted under the firm name of Paul Rising & Co., Chartered Accountants, with offices at 615 W. Hastings St., Vancouver.

* * *

Mr. Gordon Cruickshank, C.A. announces the opening of an office for the practice of his profession at Ste. 9, 416 W. Pender St., Vancouver.

## MANITOBA

G. M. Horne & Co., Chartered Accountants, Winnipeg, announce the opening of a branch office at Virden, Man.

## NEW BRUNSWICK

At a congratulatory dinner held by the New Brunswick Institute, six new chartered accountants received their certificates. Mr G. A. Oulton, president, made the presentations. Guest speaker of the evening was Dr W. T. R. Flemington, president of Mount Allison University. He was introduced by Mr J. A. Marven.

## ONTARIO

Mr R. J. McKessock, C.A. announces the opening of an office for the practice of his profession at 10 Francis Block, Fort William.

ONTARIO

Ottawa Chartered Accountants Club

On January 22 the Ottawa C.A. Club heard Mr. Clayton F. Elderkin, C.A., Inspector General of Banks, speak on "Bank Inspection in Canada", and on March 19 their meeting was addressed by Mr. Sidney Turk, chief of the Bank of Canada's Foreign Exchange Department. His topic was "The Foreign Exchange Market in Canada". The new C.A.'s in the Ottawa district were introduced and announcement was made of the winners of the club's awards given to the three candidates obtaining the highest marks in the Ottawa District.

QUEBEC

Quebec Students' Society

The Chartered Accountants' Students' Society of Quebec conducted a tax forum recently in the Montreal High School Auditorium. Henry Dainow, C.A. spoke on corporation tax changes; Lloyd H. Paul, C.A. discussed personal tax changes; and H. B. Savage, C.A. also pointed out some special features.

# News of Our Members

Mr G. V. Ashworth, C.A. (Ont.), has been appointed comptroller of The Telegram Publishing Co., Toronto.

* * *

Mr Harry D. Patriquin, C.A. (Alta.), has been elected president of the Edmonton Chamber of Commerce.

Mr. James Blyth, C.A. (B.C.; Sask.), has been appointed comptroller of Brazilian Traction, Light & Power Company.

* * * *

Grand & Toy Limited announce the appointment of Mr. Roger I. Priddle, C.A. (Ont.), as controller.

# Obituaries

## Richard Heyward Bounsall

The Institute of Chartered Accountants of Ontario announces with regret the death of Richard Heyward Bounsall at his home in Ottawa on March 28, 1953.

Mr. Bounsall was born at Blenheim, Ontario and educated at Chatham. He was admitted to membership in the Institute in 1919 and established his own firm. In 1944 he was elected a Fellow of the Institute for distinguished services to the profession. He served on the Council of the Institute for three years.

To his wife and family the Institute extends sincere sympathy.

## William Raymond Jex

The Institute of Chartered Accountants of Manitoba announces with deep regret the death of William Raymond Jex in his 79th year on March 6, 1953.

Born in Birmingham, England, the late Mr. Jex came to Canada in 1888 with his parents and lived in London, Ontario. In 1910 he went to Winnipeg and 1915 he was admitted to the Manitoba Institute. For many years he practised his profession as head of his own firm.

To his widow and family the members of the Institute extend their sincere sympathy.

# Accounting Research

**Reports of Studies by**
**The C.I.C.A. Research Department**

## AN ANALYSIS OF PRESENTATION TECHNIQUES IN ANNUAL FINANCIAL REPORTS

THE preceding two articles dealt with balance sheet items and their presentation in financial reports of Canadian companies. The following are some of the highlights of the analyses of the statements of profit and loss for years 1951, 1950, and 1949.

### Statement of Profit and Loss

*Title of Statement*

The statements of profit and loss of Canadian companies are designated by a wide variety of titles. In 208 out of 279 statements included in the 1951 analysis they were described as "Profit and Loss" statement as compared with 154 out of 209 in the 1950 analysis and 144 out of 202 in the 1949 analysis. The table in Fig. 1 sets out the variety of titles used to describe the statement in 1951.

The miscellaneous category includes: statement of operations and profit and loss, statement of income retained in the business, statement of net profit, statement of earnings, etc.

*Form*

While most companies presented separate statements of profit and loss and of surplus, 72 in 1951, 70 in 1950, and 68 in 1949 presented combined statements of profit and loss and of surplus.

Although many companies continue to use the ordinary form of profit and loss

TITLES OF STATEMENT OF PROFIT AND LOSS

| Number | Title |
|---|---|
| 168 | Profit and loss |
| 40 | Profit and loss and (earned) surplus |
| 23 | Income and expenditure |
| 5 | Income and expenditure and surplus |
| 10 | Income |
| 2 | Income and earned surplus |
| 5 | Profit and loss and earnings retained and used in the business |
| 3 | Summary of earnings |
| 2 | Operations |
| 5 | Earned surplus |
| 16 | Miscellaneous |
| 279 | |

Fig. 1

statement in which various items of income and expense are grouped and which presents intermediate balances before arriving at the figure of net profit or loss for the year, the increased prominence of the "Single Step" and "Single Step and Taxes" form is evidenced by the following percentage of statements presented in either of these two forms — 29% in 1949, 52% in 1950, and 50% in 1951.

The *single step set-up* of the profit and loss statement presents an arrangement of all income items first, followed by a listing of all expense items. The total of the latter is then deducted from the total of the former (or *vice versa*) to arrive at the net profit (or loss) for the year.

The *single step and taxes set up* of the profit and loss statement is the same as described above, except that the estimated taxes on income are shown separately as a deduction from the net figure of total income less total expenses to arrive at the net profit or loss for the year.

## Specific Items on Profit and Loss Statement

### *Designation of the Net Profit of the Year*

In 218 cases in 1951, 159 in 1950, and 128 in 1949, the last figure in the profit and loss statement or in the profit and loss section of the combined statements was described as the "net profit for the year" or "net income", etc. However, in 44 instances in 1951, 32 in 1950, and 16 in 1949, the net figure from the operations of the year was not designated by name, but it was left to the reader to determine for himself which of the balances extended, if any, was the net profit for the year. In the remaining instances the figure described as the net profit for the year was followed by such appropriations as — dividends, adjustment of inventory reserves, minority interest, transfers to and from reserves, amortization of bond discount, discount on preferred shares redeemed, etc.

### *Depreciation*

In the 1951 financial statements, 269 set out the dollar value of the annual estimated depreciation — 228 as a separate figure before net profit, 23 as a footnote and 18 in the description of the operating profit. In addition, three of the statements analyzed set out as separate figures the depreciation provision calculated at the normal rate and the excess of the capital cost allowance calculated at the maximum rates allowed by the Income Tax Act and Regulations over normal depreciation which was recorded in the accounts in order to enable the company to claim it for tax purposes. Of the seven instances in which no depreciation was shown, two had made no current provision and five were incorporated under provincial law which did not require such disclosure.

Although in most cases the basis of the calculation of the current depreciation was not disclosed, reference was made in several directors' reports to the impact of the Income Tax Act and Regulations on capital cost allowances. Without setting out the net dollar effect, many directors stated that current depreciation had been calculated at the maximum rates allowable under the Income Tax Act and Regulations.

The following are excerpts from financial statements which indicate the various ways in which recognition is given to the effect of the tax requirements as they relate to the companies concerned:

*Example 1*

**In Statement of Profit and Loss**

| | |
|---|---|
| **Provision for depreciation at company's normal rates** | **$304.537** |

| | |
|---|---|
| Profit after normal depreciation | 26,851 |
| Provision for additional depreciation allowed under Income Tax Regulations | 209,971 |
| Net loss for year before tax recovery | $183,120 |

*Example 2*

In Statement of Profit and Loss

| | | |
|---|---|---|
| Provision for depreciation at rates approved by the . . . Board of Commissioners of Public Utilities | | $681,313 |

In Statement of Earned Surplus

| | | |
|---|---|---|
| Additional Provision for Depreciation — provided in order to claim for income tax purposes the maximum annual allowance at rates established by Schedule B of Part XI of the Income Tax Regulations | $389,341 | |
| *Less* | | |
| Reduction in provision for income taxes as a result thereof | 197,715 | 191,626 |

*Example 3*

In Statement of Revenues and Expenditure

| | |
|---|---|
| Depreciation | $63,842.28 |

In Statement of Earned Surplus

| | |
|---|---|
| Additional depreciation (less tax savings) | $27,864.67 |

*Example 4*

In Statement of Profit and Loss

| | |
|---|---|
| Capital cost allowances in respect of lands, plants and facilities (depreciation and depletion) | $27,580,624 |

And in a note to the statement

The Canadian Income Tax Act provides for capital cost allowances in respect of facilities under construction as well as facilities in use and, in addition thereto, accelerated allowances, under certain circumstances. The total capital cost allowances, including accelerated allowances, charged to operations in respect of facilities under construction amounted to $12,717,283 in 1951 and had the effect of reducing net profit for the year by $6,918,202.

### *Interest on Funded Indebtedness*

All but 32 of the 1951 financial statements concerned set out separately the dollar value of the current interest on long-term indebtedness. Of these, 16 were companies incorporated under the *Companies Act, 1934 (Canada)* while 16 were companies incorporated under provincial laws which did not require this item to be shown separately.

### *Income from Non-consolidated Subsidiaries*

Of the 81 companies which did not consolidate all their operating subsidiaries in preparing the 1951 financial statements, 25 set out separately the income received from non-consolidated subsidiaries, while 15 included this income in "Income from Investments". The auditors' reports on 27 of the financial statements brought to light the fact that the profits and losses of non-consolidated subsidiaries had not been taken into account in preparing the financial statements. In the balance of the cases there was no indication as to the recognition given to profit or loss of the operating non-consolidated subsidiaries.

### *Taxes on Income*

In the 279 financial reports analyzed for 1951, the dollar value of the estimated taxes on income was set out as follows:—

262 — before net profit
2 — after net profit

2 — as a footnote
3 — as a deduction in earned surplus
1 — no provision shown.

The remaining nine statements showed a loss on the current year's operations, and eight of these indicated the effect of the loss carry-over provisions of s. 26 of the Income Tax Act. In seven instances the tax adjustment as a result of the carry-back of the current loss was included in the statement of profit and loss as recommended by Bulletin No. 3; in one instance the amount was included in the statement of earned surplus.

# A Letter from a Reader

## A STUDENT'S CONCEPT

*Toronto, March 10, 1953*

Sir: I have read *The Tax Review* for February containing the editorial comment that Canada was at the crossroads between the statutory and accounting concept of business income, and I am sending my views on this subject.

As students-in-accounts (I have still a supplemental in Auditing) we are taught the various methods of calculating the annual charge for depreciation. In addition, we are taught that depreciation is the amount of services of an asset which has been used during a given period. In practice, however, it has been my experience, admittedly limited, that the only problem arising with the charge for depreciation was the amount allowed by the *Income Tax Act*. It seems to follow that if we so easily give up our concept of the purpose of depreciation, then we must be prepared to give up other concepts governing measurement of income.

I am possibly missing some more important point but I wonder what effect, if any, would have resulted if, when the *Income Tax Act* revised the computation of depreciation in 1949, accountants as a group had disregarded the Act and used the concepts we have been taught. At least this would indicate a conviction that we believed in our concepts.

K. M. CANNON

# The Students' Department

**J. E. Smyth, C.A., Editor**

## NOTES AND COMMENTS

THE British firm of chartered accountants, Russell Tillett & Co., have reported as follows on the balance sheet of a furniture manufacturing company as of 30 Sept 1952:

> Our investigation and audit have disclosed various defects in the company's accounting system and there are still certain matters as indicated in the directors' report on which inquiry is not complete.
>
> Subject as aforesaid and to the notes on this page, we have obtained all the information and explanations which, to the best of our knowledge and belief, were necessary for the purposes of our audit.
>
> In our opinion proper books of account were not kept by the company. We have examined the above balance sheet and annexed profit and loss account which are in agreement with the books of account as adjusted by us to accord with the information obtained by us in the course of our investigation and audit.
>
> Subject as aforesaid and to the notes on this page and to the matters set out in the directors' report, in our opinion and to the best of our information and according to the explanations given to us, the said accounts give the information required by the *Companies Act, 1948,* in the manner so required and the balance sheet gives a true and fair view of the state of the company's affairs as at September 30th, 1952, and the profit and loss account gives a true and fair view of the loss for the fifteen months ended on that date.

The firm of chartered accountants which made the above audit report was instructed to investigate the company's affairs in October 1952 after the former auditors had resigned. As a result of the October investigation a substantial loss of capital was indicated. The company's financial position was, among other things, attributed to a faulty internal system of estimating and costing which resulted in manufacturing losses continuing undetected. The board of directors requested and received the resignation of their chairman. The company's solicitors have been instructed to look into the liability of any or all of the directors for the losses revealed. A competent full-time financial and cost accountant has been appointed and "measures have been initiated with a view to the institution of an efficient system of cost control and estimating".

The circumstances of the above investigation and audit are the subject of comment in the Finance and Commerce section of *The Accountant,* February 14, 1953, from which source we have derived our information.

* * * * * *

On a less important matter, but closer to home, we note with dismay that the recent published balance sheet of one of the largest Canadian trust companies is dated *for the year ended* December 31, 1952. We trust it is only a printing error.

* * * * * *

A contemporary of ours, the Students' Department in *The Canadian Journal of Accountancy,* contains in its March 1953 issue an article by Mr. F. T. Sudbury C.P.A. entitled, "A Timely Message to Examination Candidates". We agree

with the sentiments expressed and commend the article in its entirety to readers of this Department. For example, one of the points Mr. Sudbury makes is as follows:

> The "frame of mind" in which a candidate enters an examination room will, to a not inconsiderable extent, influence his chances of success. So first of all, let's shake hands with the examiners, in a friendly fashion. Do not harbor the misanthropic thought that the examiners are ogres who are with evil glee planning your downfall. On the contrary they devote much time and care in the effort to present questions which will elicit from you anwsers which prove that you have in fact become enlightened and informed in respect of the subjects within the curriculum of the Association [The Certified Public Accountants Association of Ontario] . . . .
>
> Enter the examination room, therefore, in a spirit of co-operation with the examiners. Do not allow your efforts to be spoiled by some hostile thought that the examiners are trying to "trick" you or to "catch" you. There is no such desire, no such intention. Just try to prove to the examiners that no matter what question is presented, you have so trained yourself that you are able to give a reasonable and intelligent answer.
>
> While in the examination room do not allow your equanimity to be disturbed by feelings of irritation, annoyance, resentfulness, or alarm. Regard each question, not as a snare, but as an opportunity for you to display your resourcefulness. Strive to impress the examiner with your ability to meet any set of circumstances with good sense and intelligence.

## SOLUTION TO THE APRIL PUZZLE

| | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | $1 | deposited | by | a | son | would | add | $7 | to | the | total |
| the | next | $1 | " | " | this | " | " | " | 13 | " | " | " |
| " | " | " | " | " | " | " | " | " | 19 | " | " | " |
| " | " | " | " | " | " | " | " | " | 25 | " | " | " |
| " | " | " | " | " | " | " | " | " | 31 | " | " | " |
| " | " | " | " | " | " | " | " | " | 37 | " | " | " |
| " | " | " | " | " | " | " | " | " | 43 | " | " | " |
| " | " | " | " | " | " | " | " | " | 49 | " | " | " |

From the above, the following cumulative totals can be computed showing the amount added to the three accounts, in total, for any given number of dollars deposited by a given son:

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| $1 | deposited | would | result | in | $7 | added | to | the | total; |
| $2 | " | " | " | " | 20 | " | " | " | " |
| $3 | " | " | " | " | 39 | " | " | " | " |
| $4 | " | " | " | " | 64 | " | " | " | " |
| $5 | " | " | " | " | 95 | " | " | " | " |
| $6 | " | " | " | " | 132 | " | " | " | " |
| $7 | " | " | " | " | 175 | " | " | " | " |

Since the father made initial deposits totalling $3, it remains to be found what further amounts deposited by the sons would add $197 to the total. A little contemplation shows that *$5 deposited by two of the sons and $1 deposited by the third* would result in $197 being added to the total [$95 + $95 + $7].

## PUZZLE FOR MAY

"Isn't that your old motorcycle?" I asked Alfred.

"That's right," said Alfred. "I first bought it about a year ago. I sold it to Larry at a profit of 25 per cent, and then Larry sold it to Henry at a loss of 10 per cent. Henry next disposed of it to Dusty at a profit of 33-1/3 per cent, but poor old Dusty made a loss of 20 per cent when he sold it back to me."

"And how much have you paid for it?" I asked. Alfred grinned. "$8 more than I paid the first time."

*What did he give for the motorcycle originally?*

(Contributed by a Vancouver reader)

## AN ACCOUNTING TEASER

(From "The Choice Before Us" by George O. May, *The Journal of Accountancy*, March 1950)

Assume two students were asked to undertake tasks for which each was to receive $25 providing his was accomplished within three days. One of the students put in very intensive work and completed the task in one day, and received his $25. The other did a full third of the task in the first day, but on the second day events happened which prevented him from completing it. Did he earn $8.33 the first day and lose it the second day, or did he earn nothing either day?

Mr. May has the following to say in reply to his own question: "The simple fact is that what is deemed to be income for a given year depends in part on what has been treated as income in the past and in part also on what is expected to happen in the future, so that it cannot be a factual determination."

## PROBLEM 1

### Intermediate Examination, October, 1952

*Accounting I, Question 3 (20 marks)*

The following are the balance sheets of two companies in the same line of business as at 30 Sept 1952:

ASSETS

| | A Co. Ltd. | B Co. Ltd. |
|---|---|---|
| **Current Assets** | | |
| Cash | $ 129,000 | $ 39,000 |
| Dominion of Canada bonds | 75,000 | 25,000 |
| Accounts Receivable | 127,000 | 98,000 |
| Less—allowance for doubtful debts | (12,100) | (9,600) |
| Inventories—merchandise | 200,000 | 225,000 |
| —supplies | 10,000 | 9,000 |
| Prepaid—insurance | 7,400 | 3,600 |
| —taxes | 2,700 | 5,000 |
| | $ 539,000 | $ 395,000 |
| **Fixed Assets** | | |
| Land | $ 90,000 | $ 100,000 |
| Buildings | 145,000 | 153,000 |
| Less—accumulated depreciation | (56,000) | (65,000) |
| Machinery and equipment | 179,000 | 211,000 |
| Less—accumulated depreciation | (27,000) | (30,000) |
| | $ 331,000 | $ 369,000 |

| | | |
|---|---|---|
| **Other Assets** | | |
| Goodwill, patents etc. | $ 30,000 | $ 40,000 |
| | $ 900,000 | $ 804,000 |

LIABILITIES AND CAPITAL

| | | |
|---|---|---|
| **Current Liabilities** | | |
| Bank loan | $ 40,000 | $ 50,000 |
| Accounts payable | 100,000 | 150,000 |
| Income taxes payable | 50,000 | 25,000 |
| | $ 190,000 | $ 225,000 |
| **Capital and Surplus** | | |
| Capital stock—40,000 shares | $ 400,000 | $ 400,000 |
| Surplus | 195,000 | 150,000 |
| Net profit for the year | 115,000 | 29,000 |
| | $ 710,000 | $ 579,000 |
| | $ 900,000 | $ 804,000 |
| Sales for the year | $2,000,000 | $1,125,000 |
| Cost of goods sold for the year | $1,600,000 | $ 843,750 |

**Required:**

Compute, and describe briefly the significance of, the various ratios and comparative figures which are useful in making a comparison of the two companies.

## A SOLUTION

### A CO. LTD. AND B CO. LTD.

### Comparison of Significant Ratios

### 30 Sept 1952

**Current Ratio**—The ratio of current assets to current liabilities determines the adequacy of working capital to finance everyday operations. It compares cash and assets convertible into cash within one year with the short-term debts of the company.

| | A Co. Ltd. | B Co. Ltd. |
|---|---|---|
| Current assets | $539,000 | $395,000 |
| Current liabilities | 190,000 | 225,000 |
| Working capital | 349,000 | 170,000 |
| Ratio of current assets to current liabilities | 2.84:1 | 1.76:1 |

**Quick asset ratio**—The ratio of current assets (exclusive of inventories) to current liabilities determine the ability to meet liabilities quickly and on time without a forced liquidation It also reveals the degree of dependence on trade creditors for funds.

| | | |
|---|---|---|
| Current assets | $539,000 | $395,000 |
| *Less* inventories | 200,000 | 225,000 |
| Liquid assets | 339,000 | 170,000 |
| Current liabilities | 190,000 | 225,000 |

| | | |
|---|---|---|
| Liquid capital | 149,000 | (55,000) |
| Liquid ratio | 1.8:1 | 1:1.3 |

B. Co. Ltd. is leaning on its creditors and the bank to furnish working capital in the form of inventory while A Co. Ltd. is able to finance its inventory out of its own capital resources, requiring current funds only to meet current obligations.

**Collection Ratio**—The ratio of sales to outstanding receivables reveals the rate of collection of accounts. The trend of this ratio over a period of years shows whether collections are improving or deteriorating relative to sales volume. The ratio also shows whether sales are being made at the risk of potential heavy bad debt losses.

| | A Co. Ltd. | B Co. Ltd |
|---|---|---|
| Sales | $2,000,000 | $1,125,000 |
| Accounts receivable | 127,000 | 98,000 |
| Ratio | 16:1 | 11.5:1 |

A Co. Ltd. has a much more effective credit policy and collection record than B Co. Ltd. and its potential bad debt risk is smaller. The accounts receivable of B Co. Ltd. probably contain a larger number of doubtful or bad accounts. B Co. Ltd. appears to be pushing sales at the expense of credit losses. The accounts of A Co. Ltd. are more valuable in total and a better security for loans.

**Turnover**—Comparison of cost of sales to inventory reveals the condition of inventory and the probability that slow and obsolete items are included in the inventory figure. It also shows if too much capital is tied up in inventory in relation to the volume of business being done.

| | | |
|---|---|---|
| Cost of goods sold | $1,600,000 | $ 843,750 |
| Inventory | 200,000 | 225,000 |
| Inventory turnover | 8 times | 3.75 times |

**Profit % on sales**—shows net profits earned per dollar of sales.

| | A Co. Ltd. | B. Co. Ltd. |
|---|---|---|
| Sales | $2,000,000 | $1,125,000 |
| Net Profit | 115,000 | 29,000 |
| Profit % of sales | 5.75% | 2.58% |

A Co. Ltd. has a much better profit ratio and lower overhead cost per dollar of sales. Its better gross profit ratio indicates more effective buying and selling policies.

**Fixed Asset Ratio** indicates the ratio of fixed capital investment to shareholders' equity.

| | | |
|---|---|---|
| Fixed capital | $ 361,000 | $ 409,000 |
| Shareholders' equity — first of year | 595,000 | 550,000 |
| Ratio of fixed investment to capital | 60.7% | 74.4% |

A Co. Ltd. has more capital funds available for financing current operations, and is therefore not as dependent on banks and other creditors.

**Earnings on Investment** —

| | | |
|---|---|---|
| Shareholders' equity — first of year | $595,000 | $ 550,000 |
| Net profits | 115,000 | 29,000 |
| % earnings on investment | 19.3% | 5.3% |

This ratio reveals that the goodwill of B Co. Ltd. is not very valuable and that that company has no more than normal earnings at most on its investment and perhaps even less than normal considering the risk factor.

## *EXAMINER'S COMMENTS*

Many students worked out a variety of ratios and did not attempt to specify the main ones. Their understanding of the ***significance*** of the ratios was poor. A number of students invented meaningless ratios and seemed to be grasping for straws in their haste to get something on paper.

## PROBLEM 2

### Final Examination, October 1952

*Accounting I, Question 2 (22 marks)*

R, a manufacturer of plastic articles to specific order, has requested CA to advise him as to the installation and operation of an efficient system of ascertaining and recording his factory costs.

The factory building houses the two main divisions, the machine shop and the plastics moulding department as well as the office.

The machine shop division turns out all the steel moulds used in the manufacture of the plastic articles. The machining of each mould, which involves considerable time and precision, necessitates the use of highly skilled labour.

All factory employees are paid on an hourly basis.

The plastic moulding division turns out the finished products, which consist of a wide variety of ash trays, buttons, automobile equipment, etc. In this division the process consists of placing chemical powders in a mould which is then placed under steam pressure for a few minutes. After being pressed a certain amount of finishing and inspection labour is necessary to complete the articles.

**Required:**

Outline a satisfactory cost system for this organization.

## A SOLUTION

### THE R PLASTIC MANUFACTURING COMPANY

### Outline of Proposed Cost System

1. **Preparation of original sources and supporting records**

   Materials—A detailed perpetual inventory record should be tied in to the factory ledger control.

   —Issues on an approved form must be made by the storekeeper and the particular job chargeable ascertained and noted.

   —A monthly summary of issues to jobs should be prepared as a basis for posting to the general and subsidiary ledgers.

   Labour —Time cards and a daily time sheet showing the jobs chargeable are necessary. Total wages will then be distributed to jobs on the basis of these sheets at actual cost and in hours.

   —A report on production should be recorded on the job cards from the daily time summary.

2. **Job Cards**—Each production order when approved, should be numbered and a subsidiary ledger card prepared to show:

   Material—posting of issues from stores at cost

   Labour—posting of charges from labour summary

   Production—reported production from labour reports

   Spoilage—on the basis of reports from both divisions an entry should be made recording a reduction in the quantity produced in the plastics division.

3. **Distribution of overhead expenses**

   All overhead expenses should be classified as follows:

   General and administrative

   Sales

   Plant—machine shop

   " —plastics division

   Factory expenses should be further classified into those to be charged to jobs on the basis of:

(a) materials issued
(b) labour hours
(c) labour costs.

The total overhead should be distributed to the divisions on this basis and entered on the job cards.

4. **Finished goods inventory**

As a job is completed the product should be transferred to finished goods and a count made at that time (or at the time of shipment if the item is to be shipped directly). The amount should be recorded on the job card and a calculation made as follows:

| | | |
|---|---|---|
| Production per labour report | ............... | |
| *Less* spoilage | ............... | |
| | ............... | |
| Shortage | ............... | (Shortage figures should be followed up) |
| Completed quantity | ............... | |

In a business of this kind, where no production is made for stock, the job card can be used as a finished goods record and shipping reports can be entered on the card — i.e. the quantity shipped can be recorded, and the balance shown will be the quantity on hand. This procedure will serve to control quantities from the production to the shipment stage.

Sales invoices should be typed from production orders, a duplicate serving as a shipping report which can be posted to the job card.

5. **Transfers of production orders**

Once a job is complete in the machine shop, it should be transferred as a material cost of the plastics division. Any scrap value caused by spoilage in this division should be credited at scrap value to the job.

On completion of processing in the plastics division, the job should be transferred to finished goods.

On sale, the cost of the job should be charged to cost of sales.

Entries on the job card and the journal entries in the factory ledger should coincide with the physical transfers of production. The job card will then serve in turn as a subsidiary record for work-in-process, machine shop, work-in-process plastics division and finished goods inventory, and subsequently as a basis for the cost of sales entry.

6. **Detailed records**

The production order originates the job and should be numbered serially and approved by sales manager, plant superintendent and engineers.

The job card should be in the form of a ledger card with space for material, labour, labour hours, overhead ($), production, spoilage, shortages, shipments (quantity), and selling price. A report of spoilage should be prepared for each division, classified by job. It should be made up by the inspector or foreman in charge.

A production report should be made up to show the quantity of production delivered, as per the time summary sheets.

A material issue slip in the form of an approved requisition to the storekeeper for the delivery of required materials is necessary.

The sales invoice, serving as a duplicate shipping record, will be entered on the job card to complete the history of the job.

*EXAMINER'S COMMENTS*

Some candidates described a job order cost system for the machine shop division and a process cost system for the plastic moulding division. Other candidates attempted to develop standard costs in the job order cost system. A number wasted time developing one phase excessively.

## PROBLEM 3

### Final Examination, October 1952

*Accounting I, Question 3 (15 marks)*

H Ltd. manufactures a single product and uses an estimated cost system. Based on the revised estimate of the preceding month the estimated cost of the product for the month of January is:

| | |
|---|---|
| Material | $20 |
| Labour | 6 |
| Factory service expense | |
| 2 machine hours @ $7.50 | 15 |
| | $41 |

The following transactions pertain to the month of January:

| | | |
|---|---|---|
| Work in process inventories | 70 units | 50 units |
| | Jan. 1 | Jan. 31 |
| Material | 100% complete | 100% complete |
| Labour | 40% complete | 70% complete |
| Factory service expense | 40% complete | 70% complete |
| Material put in process—actual cost | | $12,000 |
| Labour put in process—actual cost | | $ 3,200 |
| Factory service expense—actual cost | | $ 7,000 |
| Machine hours | 1,050 | |
| Units completed | 500 | |
| Units sold | 450 | |

**Required:**

Journal entries to record the above information and to adjust the variation from estimate for the month of January to inventories and to cost of goods sold.

## A SOLUTION

### BOOKS OF H LTD. — JANUARY

### JOURNAL

| | Dr. | Cr. |
|---|---|---|
| 1. Material in process | $12,000.00 | |
| Material inventory | | $12,000.00 |
| Actual cost of material put in process | | |
| 2. Labour in process | 3,200.00 | |
| Accrued payroll | | 3,200.00 |
| Actual cost of labour put in process | | |
| 3. Factory service expense | 7,000.00 | |
| Sundry accounts | | 7,000.00 |
| Actual factory service expense incurred | | |

| | | |
|---|---|---|
| 4. Factory service in process | 7,875.00 | |
| Factory service applied | | 7,875.00 |
| Actual machine hours for month | | |
| 5. Finished goods inventory | 20,500.00 | |
| Material in process | | 10,000.00 |
| Labour in process | | 3,000.00 |
| Factory service expense in process | | 7,500.00 |
| Transfer estimated cost of units completed 500 @ $41.00 | | |
| 6. Cost of goods sold | 18,450.00 | |
| Finished goods inventory | | 18,450.00 |
| Estimated cost of goods sold | | |
| 7. Cost adjustment account | 2,828.00 | |
| Material in process | | 2,400.00 |
| Labour in process | | 158.00 |
| Factory service expense in process | | 270.00 |
| Adjust work in process to estimated cost (See Schedule 1 for details) | | |
| 8. Factory service expense applied | 7,875.00 | |
| Factory service expense | | 7,000.00 |
| Cost adjustment account | | 875.00 |
| Close out applied factory service account | | |
| 9. Material in process | 250.00 | |
| Labour in process | 10.91 | |
| Finished goods | 205.87 | |
| Cost of goods sold | 1,527.99 | |
| Factory service expense in process | | 41.77 |
| Cost adjustment account | | 1,953.00 |
| Distribute net variances (see schedule 2) | | |

*Schedule 1*

CALCULATION OF VARIATION FROM ESTIMATE FOR JANUARY

| | Work in process Jan 31 per books | Work in process Jan 31 on Estimated Basis | Variation |
|---|---|---|---|
| Material | | | |
| 50 units @ $20 | $3,400 | $1,000 | $2,400 |
| Labor | | | |
| 50 units 70% complete @ $6 | 368 | 210 | 158 |
| Factory service expense | | | |
| 50 units 70% complete @ $15 | 795 | 525 | 270 |
| | $4,563 | $1,735 | $2,828 |

*Schedule 2*

ALLOCATION OF VARIATION

| | Material | | | Labor | | | Factory Service Expense | | |
|---|---|---|---|---|---|---|---|---|---|
| | Units | % | Effect. Units | Units | % | Effect. Units | Units | % | Effect. Units |
| Opening inventory needed to complete | 70 | | | 70 | 60 | 42 | 70 | 60 | 42 |
| Started and finished | 430 | 100 | 430 | 430 | 100 | 430 | 430 | 100 | 430 |
| Complete in closing inventory in process | 50 | 100 | 50 | 50 | 70 | 35 | 50 | 70 | 35 |
| | | | 480 | | | 507 | | | 507 |
| Total variances | | | $2,400 | | | $158 | | | $605* |
| Effective units | | | 480 | | | 507 | | | 507 |
| Variance per unit | | | $ 5 | | | $.3116 | | | $1.1933* |
| Corrections: | | | | | | | | | |
| Work in process | 50 | | $250 | 35 | | $ 10.91 | 35 | | $41.77* |
| Finished goods | 50 | | 250 | 50 | | 15.53 | 50 | | 59.66* |
| Cost of goods sold | 380 | | 1,900 | 422 | | 131.56 | 422 | | 503.57* |
| | 480 | | $2,400 | 507 | | $158.00 | 507 | | $605.00* |

N.B—* indicates credit

## *EXAMINER'S COMMENTS*

The candidates on the whole seemed to know what was required.